

17.03 Financial Statement Disclosures

F/S must be accompanied by informative disclosures which will assist in understanding and interpreting the F/S. (ASC 235)

Summary of Significant Accounting Policies

One note that is always included is the **summary of significant accounting policies (1st footnote)**. This note identifies the choices made by the client for those items that have more than one acceptable approach under GAAP. This discusses the accounting principles selected where GAAP allows alternatives, the methods of applying those principles, as well as other information about unusual or innovative principles that the client is applying.

Examples include:

- Revenue recognition policies
- Inventory costing system (eg, FIFO, LIFO)
- Depreciation method (eg, straight-line, sum-of-the-years' digits)
- Long-term construction accounting method
- Criteria for classification of investments (eg, cash equivalents, trading securities)

There is no disclosure of methods required when only one method is acceptable, such as the use of expensing for research and development costs or the inclusion of cash in bank at the reconciled account balance. The user of the F/S only needs to be informed when there was a different approach that might have been used, so as not to be confused by differences resulting from accounting methods that vary from company to company.

Long-Term Obligations

Another disclosure that is necessary in the notes to the F/S for almost every company is for **long-term obligations**. To assist the user in identifying potential cash flow problems in future years, this disclosure must report legal commitments to cash payments in connection with:

- Notes and bonds payable (including obligations to make payments to a sinking fund)
- Leases (both operating and finance)
- Unconditional purchase obligations extending more than 1 year

All **fixed and determinable** payment obligations of the client as of the balance sheet must be disclosed, but a distinction is made between those payments due within 5 years of the balance sheet date and those not due until after that time:

- Payments due within the **next 5 years** will be identified year by year.
- All payments due after that are **aggregated** into a single amount.

For example, if a client signs an 8-year lease agreement on 7/1/X1 requiring payments of \$10,000 per year beginning with the date of signing, a disclosure of the long-term obligations in the notes to the 12/31/X1 F/S would appear as follows:

20X2	\$ 10,000
20X3	10,000
20X4	10,000
20X5	10,000
20X6	10,000
<u>After 12/31/X6</u>	<u>25,000</u>
Total	\$75,000

Related parties – This discusses major transactions with related parties (owners, management, employees, affiliates) and identifies all parties who control or are controlled by the entity, even if no transactions have occurred with them. Special disclosure is not required when a transaction is obviously with a related party, such as dividends (that are obviously being paid to owners), and wages (that are obviously being paid to employees in the ordinary course of business).

There is **no requirement to disclose** related-party transactions if they are either:

- Compensation arrangements with employees (including management) arising in the ordinary course of business, or
- Eliminated in the preparation of combined or consolidated F/S.

The AICPA has stated that coverage of related party transactions will be exclusive to the AUD exam as of April 1, 2017.

Special Purpose Frameworks

F/S may be prepared in conformity with a comprehensive basis of accounting other than GAAP (OCBOA), referred to as a special purpose framework. Some different methods include:

- Cash receipts and disbursements basis
- Income tax basis
- A method prescribed by a regulatory agency

In addition to normal disclosures, a description of the basis being used and its major differences from U.S. generally accepted accounting principles should be provided in the notes to the F/S.

Prospective Financial Statements

Prospective financial information is any information about the future, and is considered an Attestation engagement, discussed in the Audit exam. There are 2 types of statements:

- **Forecast** – what management **expects** to occur in the future (General or Limited use).
- **Projection** – what management believes will occur given certain **hypothetical** assumptions (Limited use only).

- Must perform work using due professional care and in accordance with GAAP.
- A summary of significant accounting policies and assumptions must be disclosed.
- The services that may be performed include an Examination, Compilation or Agreed-upon-procedures report.